

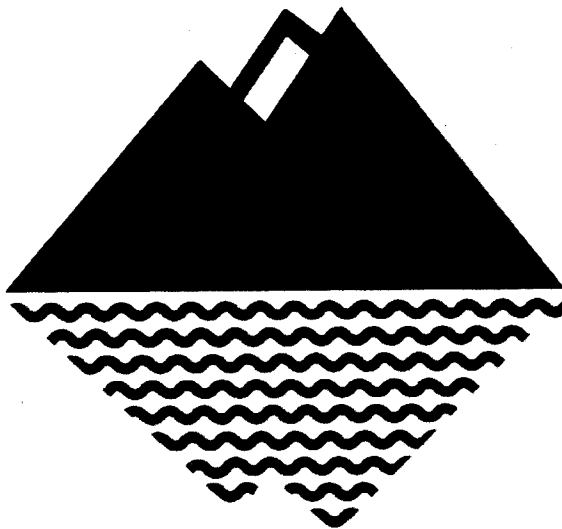
SENATE TAXATION

EXHIBIT NO. 1

DATE 3-15-11

BILL NO. SB398

The Revenue and Taxpayer Impacts of the Income Tax Provisions of SB 407



Montana Department of
REVENUE

Tax Policy and Research
Montana Department of Revenue
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Executive Summary

Senate Bill 407, enacted in the 2003 legislative session, made significant revisions to Montana's individual income tax system. The changes became effective in the 2005 tax year. Our study of actual 2005 tax returns reveals the following conclusions.

- The total amount of tax reduction granted by this legislation was almost four times greater than estimated at the time of enactment: \$100.3 million vs. the 2003 prediction of \$26 million.
- Higher income taxpayers received more tax reduction than predicted, and lower income taxpayers received less. Households earning \$500,000 or more annually received 47.7% of the tax reduction as compared to the 22.9% share predicted in 2003. These are the details:

Annual incomes less than \$65,000: This income range includes 81% of Montana households (320,942 households). These households received 7.2% of the reduction: \$7.2 million or approximately \$23 dollars for each household. The tax reduction for these households is about 12% less than the \$8.2 million predicted in 2003.

Annual incomes between \$65,000 and \$150,000: This income range includes 15.9% of Montana households (63,015 households). These households received 16.9% of the reduction: \$17.0 million or \$269 for each household. The tax reduction for these households is approximately 194% greater than the \$5.8 million predicted in 2003.

Annual incomes between \$150,000 and \$500,000: This income range includes 2.6% of Montana households (10,460 households). These households received 28.2% of the reduction: \$28.3 million or \$2,705 per household. The tax reduction for these households is approximately 365% greater than the \$6.1 million predicted in 2003.

Annual incomes of \$500,000 and up: This income range includes 0.4% of Montana households (1,567 households). These households received 47.6% of the tax reduction: \$47.8 million or \$30,499 per household. The tax reduction for these households is 701% greater than the \$6 million predicted in 2003.

- The majority of households—65% or about two-thirds—experienced only a small change (less than \$50) in their tax. The other third either received a tax cut of \$50 or more (29% of households) or paid at least \$50 more (6% of households).
 - Who received the tax cuts of \$50 or more? Only at income levels of \$70,000 or more did a majority of households see a tax reduction of at least \$50, with the percentage rising steadily to 94% for households with incomes of at least \$500,000.
 - Who paid at least \$50 more in taxes? The percentage of households paying at least \$50 more is highest (20%) for households with incomes between \$60,000 and \$75,000.
- To put these numbers in context, the average tax relief for the 1586 households earning \$500,000 or more, \$30,499, is greater than the \$29,150 average annual pay of Montana jobs covered by workers compensation, as reported by the Bureau of Labor Statistics.

Introduction

The 2003 legislature passed SB407, which made significant changes to Montana's income tax, with the expectation that the changes would reduce income tax revenue. To replace the lost income tax revenue, SB407 imposed a limited sales tax on accommodations and rental cars and increased the excise taxes on cigarettes and tobacco products. The overall bill was intended to increase revenue from the time the sales and excise tax increases went into effect in 2003 until the income tax provisions went into effect in 2005. It was intended to be revenue neutral for the first full-year of the income tax changes and then result in net revenue reductions in later years.

SB407 made three significant changes to Montana's income tax:

- It restructured the rate table, reducing the number of rate brackets from ten to six, reducing the bottom rate from 2% to 1%, reducing the top rate from 11% to 6.9%, and reducing the income at which the top rate is effective from \$82,400 to \$13,900.
- It reduced the effective rates on capital gains income by giving a nonrefundable tax credit equal to 1% of capital gains income in 2006 and 2007, and 2% of capital gains income beginning in 2008.
- It capped the itemized deduction for federal income taxes at \$5,000 for single taxpayers and married couples filing separately, and \$10,000 for married couples filing joint returns. (Previously, federal income taxes paid during the tax year could be deducted in full.)

During the 2003 session, the department estimated the revenue impacts of these changes. The estimates were made using the database of 2001 full-year resident income tax returns. Future years' tax liabilities were calculated from these returns using the rate tables and other provisions that would have been in place under the old law and using the rate tables and other provisions in SB407. The differences in individual tax liabilities were used to estimate the total impact of SB407 and the distribution of those impacts among income groups.

The total tax reduction was estimated to be \$26.0 million in 2005, with lower and higher income taxpayers receiving higher percentage reductions and middle income taxpayers seeing smaller percentage reductions.

The actual impact in 2005 was estimated using the database of 2005 full-year resident income tax returns. For each return, tax liability for that return using the rate tables and other provisions that would have been in place without SB407 was calculated and compared to the actual 2005 tax liability.

The total 2005 tax reduction was \$100.3 million. The percentage reductions going to lower and higher income taxpayers were larger than expected in 2003, and the percentage reductions going to middle income taxpayers were smaller.

Tax Reduction Due to SB407

Table 1 shows the actual tax liability reported on full-year resident's income tax returns for 2005, the calculated tax liability for those returns under the pre-SB407 law, and the difference, for thirty-five income brackets and in total. The left half of the table shows the range of household incomes included in each bracket, the number of households in that bracket, and the total of their household income. The right half of the table shows the total of calculated pre-SB407 law tax liability for households in the bracket, their actual 2005 tax, and the difference.

Table 1 Impact of SB407 on Full-Year Resident's 2005 Income Tax					
Income Brackets			Tax Liability of Households in Bracket		
Income Range	Number of Households in Bracket	Total Income of Households in Bracket	Old Law (Calculated)	SB407 (Actual)	Difference Due to SB 407
\$ 0 - \$ 1,999	13,549	\$14,568,046	\$37,361	\$31,623	(\$5,738)
\$ 2,000 - \$ 3,999	17,822	53,586,607	35,443	21,751	(13,692)
\$ 4,000 - \$ 5,999	18,096	90,325,046	364,236	188,262	(175,974)
\$ 6,000 - \$ 7,999	17,239	120,605,549	821,058	470,191	(350,867)
\$ 8,000 - \$ 9,999	16,723	150,374,690	1,268,971	822,082	(446,889)
\$ 10,000 - \$ 11,999	16,095	176,940,455	1,777,699	1,236,833	(540,866)
\$ 12,000 - \$ 13,999	15,301	198,715,462	2,327,366	1,765,832	(561,534)
\$ 14,000 - \$ 15,999	14,825	222,406,117	2,931,906	2,388,450	(543,456)
\$ 16,000 - \$ 17,999	14,645	248,725,138	3,630,271	3,115,719	(514,552)
\$ 18,000 - \$ 19,999	13,799	261,978,247	4,214,879	3,805,641	(409,238)
\$ 20,000 - \$ 24,999	29,860	669,444,654	12,572,997	12,050,667	(522,330)
\$ 25,000 - \$ 29,999	24,717	678,016,388	14,553,992	14,328,423	(225,569)
\$ 30,000 - \$ 34,999	21,401	694,260,349	16,829,559	16,616,875	(212,684)
\$ 35,000 - \$ 39,999	18,447	690,729,036	18,104,498	17,807,491	(297,007)
\$ 40,000 - \$ 44,999	16,572	703,225,278	19,712,780	19,407,519	(305,261)
\$ 45,000 - \$ 49,999	14,713	698,583,047	20,693,530	20,346,593	(346,937)
\$ 50,000 - \$ 54,999	13,603	713,485,337	22,107,997	21,636,111	(471,886)
\$ 55,000 - \$ 59,999	12,312	707,604,871	22,715,489	22,141,875	(573,614)
\$ 60,000 - \$ 64,999	11,223	700,927,264	23,658,488	22,927,933	(730,555)
\$ 65,000 - \$ 69,999	9,832	662,889,471	23,159,662	22,274,271	(885,391)
\$ 70,000 - \$ 74,999	8,699	630,067,312	23,152,561	22,120,389	(1,032,172)
\$ 75,000 - \$ 79,999	7,549	584,511,701	22,197,411	20,998,845	(1,198,566)
\$ 80,000 - \$ 89,999	11,930	1,010,880,934	40,332,978	37,952,826	(2,380,152)
\$ 90,000 - \$ 99,999	8,388	794,471,339	33,571,802	31,218,435	(2,353,367)
\$100,000 - \$109,999	5,670	593,702,631	26,398,755	24,266,498	(2,132,257)
\$110,000 - \$119,999	4,092	469,651,011	21,698,819	19,748,858	(1,949,961)
\$120,000 - \$129,999	2,965	369,807,546	17,742,147	15,935,231	(1,806,916)
\$130,000 - \$139,999	2,210	297,572,548	14,866,524	13,187,310	(1,679,214)
\$140,000 - \$149,999	1,680	243,326,207	12,678,500	11,129,603	(1,548,897)
\$150,000 - \$174,999	2,957	477,414,023	26,035,950	22,444,951	(3,590,999)
\$175,000 - \$199,999	1,856	346,355,745	19,975,360	16,718,142	(3,257,218)
\$200,000 - \$299,999	3,585	863,144,801	54,094,354	44,084,486	(10,009,868)
\$300,000 - \$399,999	1,353	464,080,389	31,964,872	25,258,619	(6,706,253)
\$400,000 - \$499,999	709	316,123,141	22,612,623	17,883,401	(4,729,222)
\$500,000+	1,567	2,123,623,903	173,936,488	126,143,942	(47,792,546)
TOTALS	396,610	\$18,287,752,624	\$752,788,380	\$652,485,816	(\$100,302,564)

Table 2 shows the percentage reductions in total tax liability for each income bracket as they were estimated in 2003 and as they were calculated from the 2005 tax returns.

Table 2 Percentage Reductions in 2005 Income Tax 2003 Session Estimates and Actual				
Income Bracket	2003 Estimate		2005 Actual	
	Difference	% Difference	Difference	% Difference
\$ 0 - \$ 1,999	(\$7,739)	-40.2%	(\$5,738)	-15.4%
\$ 2,000 - \$ 3,999	(33,554)	-46.7%	(13,692)	-38.6%
\$ 4,000 - \$ 5,999	(262,205)	-47.9%	(175,974)	-48.3%
\$ 6,000 - \$ 7,999	(428,932)	-38.7%	(350,867)	-42.7%
\$ 8,000 - \$ 9,999	(521,943)	-32.7%	(446,889)	-35.2%
\$ 10,000 - \$ 11,999	(567,993)	-26.3%	(540,866)	-30.4%
\$ 12,000 - \$ 13,999	(581,633)	-19.7%	(561,534)	-24.1%
\$ 14,000 - \$ 15,999	(543,934)	-14.7%	(543,456)	-18.5%
\$ 16,000 - \$ 17,999	(431,887)	-9.6%	(514,552)	-14.2%
\$ 18,000 - \$ 19,999	(303,542)	-6.0%	(409,238)	-9.7%
\$ 20,000 - \$ 24,999	(348,382)	-2.4%	(522,330)	-4.2%
\$ 25,000 - \$ 29,999	(197,630)	-1.2%	(225,569)	-1.5%
\$ 30,000 - \$ 34,999	(319,622)	-1.7%	(212,684)	-1.3%
\$ 35,000 - \$ 39,999	(511,654)	-2.4%	(297,007)	-1.6%
\$ 40,000 - \$ 44,999	(573,135)	-2.6%	(305,261)	-1.5%
\$ 45,000 - \$ 49,999	(571,352)	-2.4%	(346,937)	-1.7%
\$ 50,000 - \$ 54,999	(606,941)	-2.5%	(471,886)	-2.1%
\$ 55,000 - \$ 59,999	(660,624)	-2.7%	(573,614)	-2.5%
\$ 60,000 - \$ 64,999	(737,230)	-3.0%	(730,555)	-3.1%
\$ 65,000 - \$ 69,999	(690,398)	-3.1%	(885,391)	-3.8%
\$ 70,000 - \$ 74,999	(619,209)	-3.0%	(1,032,172)	-4.5%
\$ 75,000 - \$ 79,999	(656,528)	-3.4%	(1,198,566)	-5.4%
\$ 80,000 - \$ 89,999	(1,048,222)	-3.4%	(2,380,152)	-5.9%
\$ 90,000 - \$ 99,999	(706,813)	-3.0%	(2,353,367)	-7.0%
\$100,000 - \$109,999	(505,442)	-2.9%	(2,132,257)	-8.1%
\$110,000 - \$119,999	(384,190)	-2.8%	(1,949,961)	-9.0%
\$120,000 - \$129,999	(406,914)	-3.7%	(1,806,916)	-10.2%
\$130,000 - \$139,999	(408,798)	-4.1%	(1,679,214)	-11.3%
\$140,000 - \$149,999	(352,659)	-4.5%	(1,548,897)	-12.2%
\$150,000 - \$174,999	(932,199)	-5.3%	(3,590,999)	-13.8%
\$175,000 - \$199,999	(831,445)	-5.9%	(3,257,218)	-16.3%
\$200,000 - \$299,999	(2,001,276)	-6.0%	(10,009,868)	-18.5%
\$300,000 - \$399,999	(1,447,824)	-7.4%	(6,706,253)	-21.0%
\$400,000 - \$499,999	(871,726)	-7.2%	(4,729,222)	-20.9%
\$500,000+	(5,973,560)	-9.7%	(47,792,546)	-27.5%
TOTALS	(\$26,047,135)	-4.8%	(\$100,302,564)	-13.3%

Overall, the tax reduction was much larger than predicted in 2003. SB407 was predicted to reduce full-year resident's 2005 taxes by 4.8% or \$26.0 million. Analysis of 2005 tax returns shows that the actual reduction was 13.3% or \$100.3 million. The impact by income bracket also is different than predicted in 2003. In general, the percentage reduction is larger than predicted for households with incomes less than \$30,000. It is smaller than predicted for households with incomes between \$30,000 and \$65,000. For households with incomes over \$65,000, the percentage reduction is larger than predicted, and for households with incomes over \$90,000 it ranges from twice to over three times larger than predicted.

Figure 1 shows the predicted and actual percentage reductions listed in Table 2.

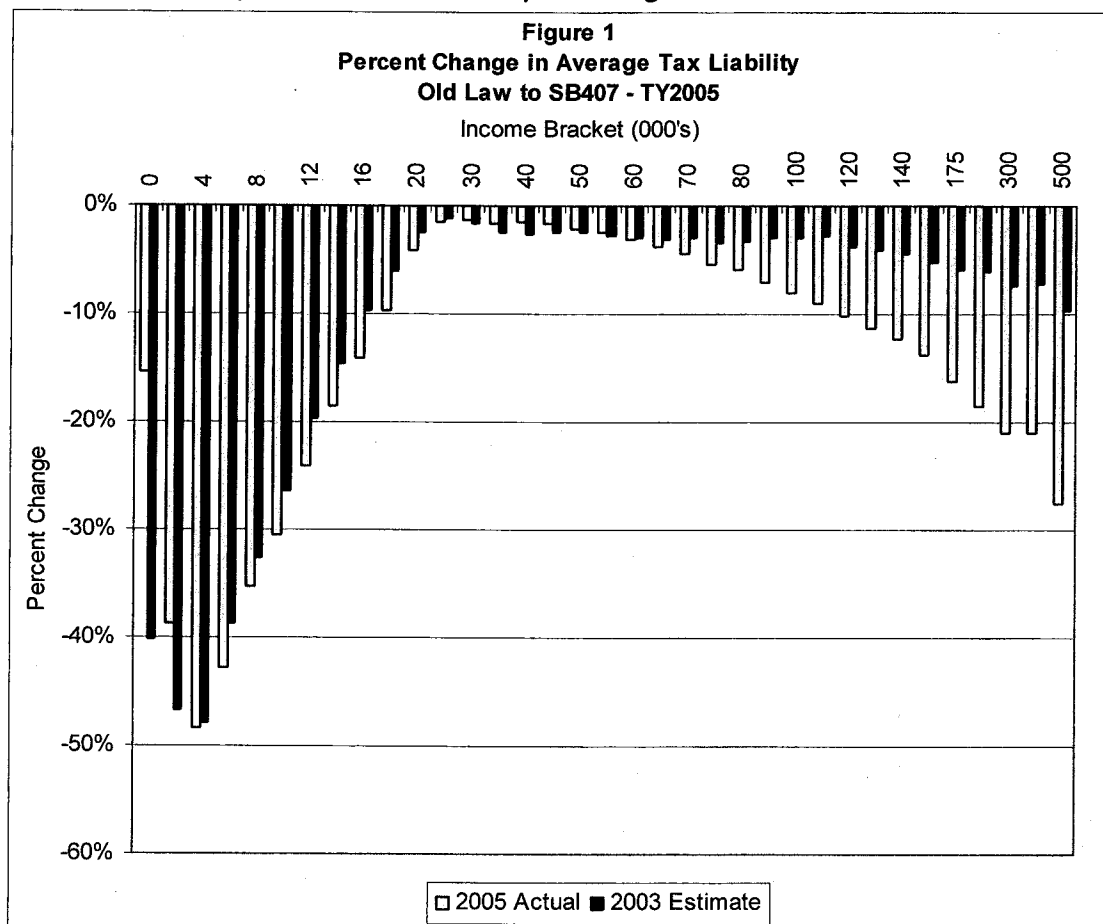
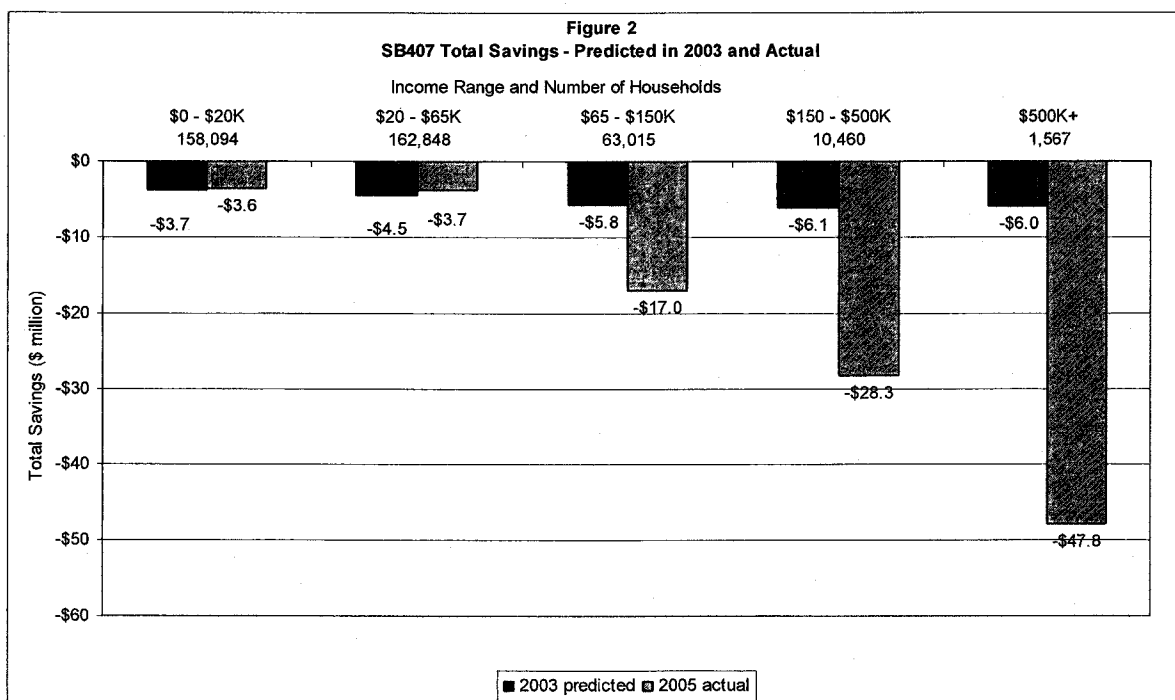


Table 3, on the next page, combines the income brackets in Tables 1 and 2 into five broad income groups and shows how the tax reduction was distributed among them. The two lowest groups combine the low and middle income brackets that received larger than expected reductions. The third group combines the middle income brackets that received smaller than expected reductions. The fourth and fifth groups combine the high income brackets that received larger than expected reductions.

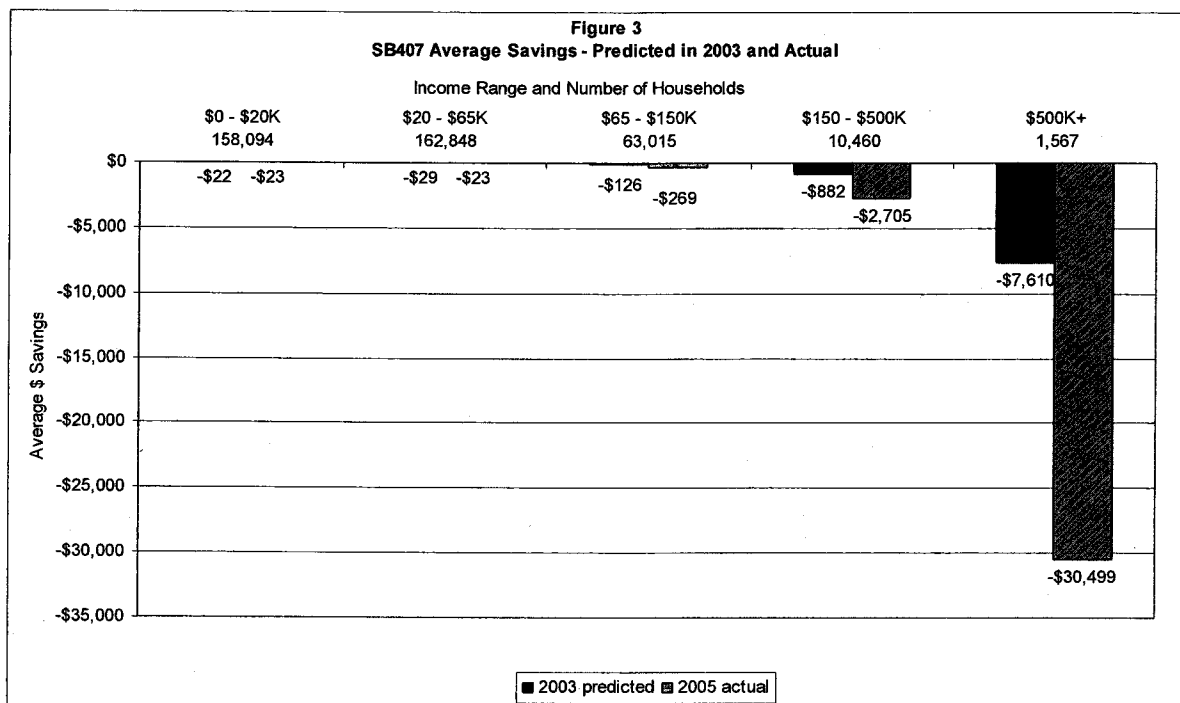
Table 3 2005 Income Tax Reductions from SB 407				
Income Bracket			Tax Reduction	Percent of Tax Reduction
Income Range	Number of Households in Bracket	Percent of Households		
\$0 - \$20,000	158,094	39.9%	(\$3,562,807)	3.6%
\$20,000 - \$65,000	162,848	41.1%	(\$3,685,842)	3.7%
\$65,000 - \$150,000	63,015	15.9%	(16,966,894)	16.9%
\$150,000 - \$500,000	10,460	2.6%	(28,293,560)	28.2%
\$500,000 +	1,567	0.4%	(47,792,546)	47.6%
Total	395,984	100.0%	(\$100,301,650)	100.0%

Almost half of the tax cut went to the 0.4% of households with income over \$500,000.

Figures 2 and 3 compare the 2003 predictions with the actual reductions for these five income groups.



In 2003, each of the three higher income groups was predicted to receive tax reductions totaling about \$6 million. The actual reductions for these groups were much larger, and the difference is larger in each succeeding higher income group. Both of the lower income groups received smaller reductions than predicted in 2003.

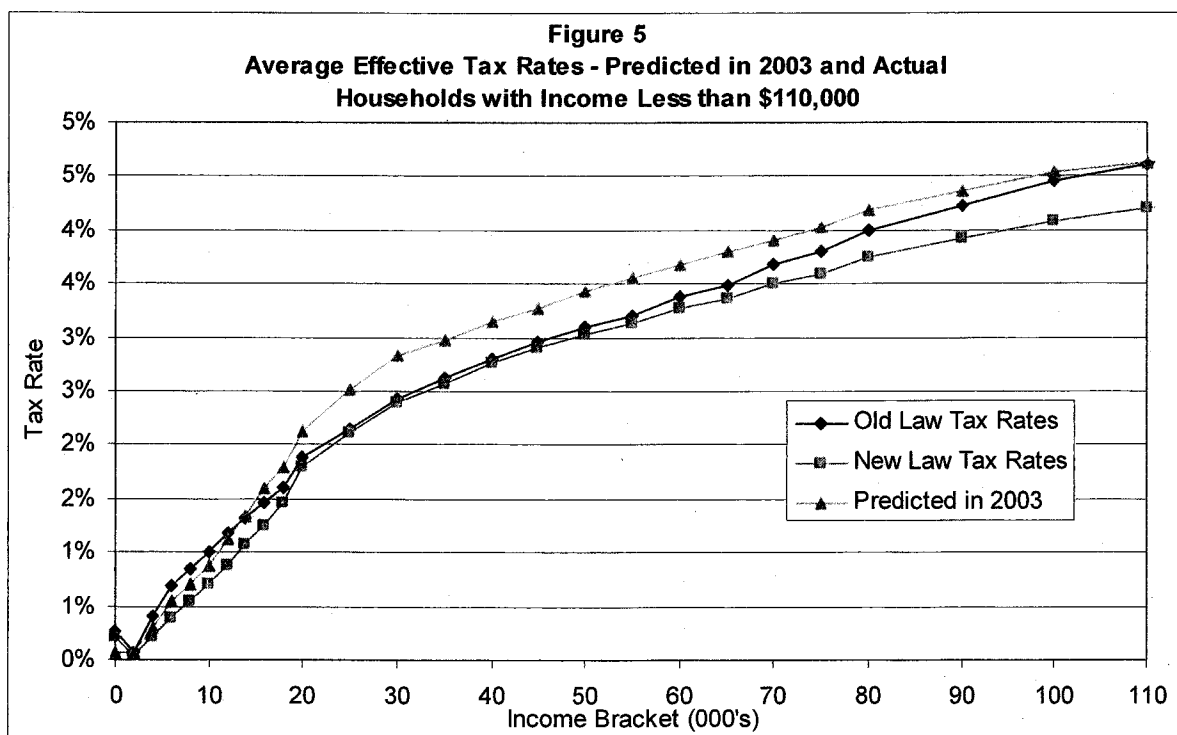
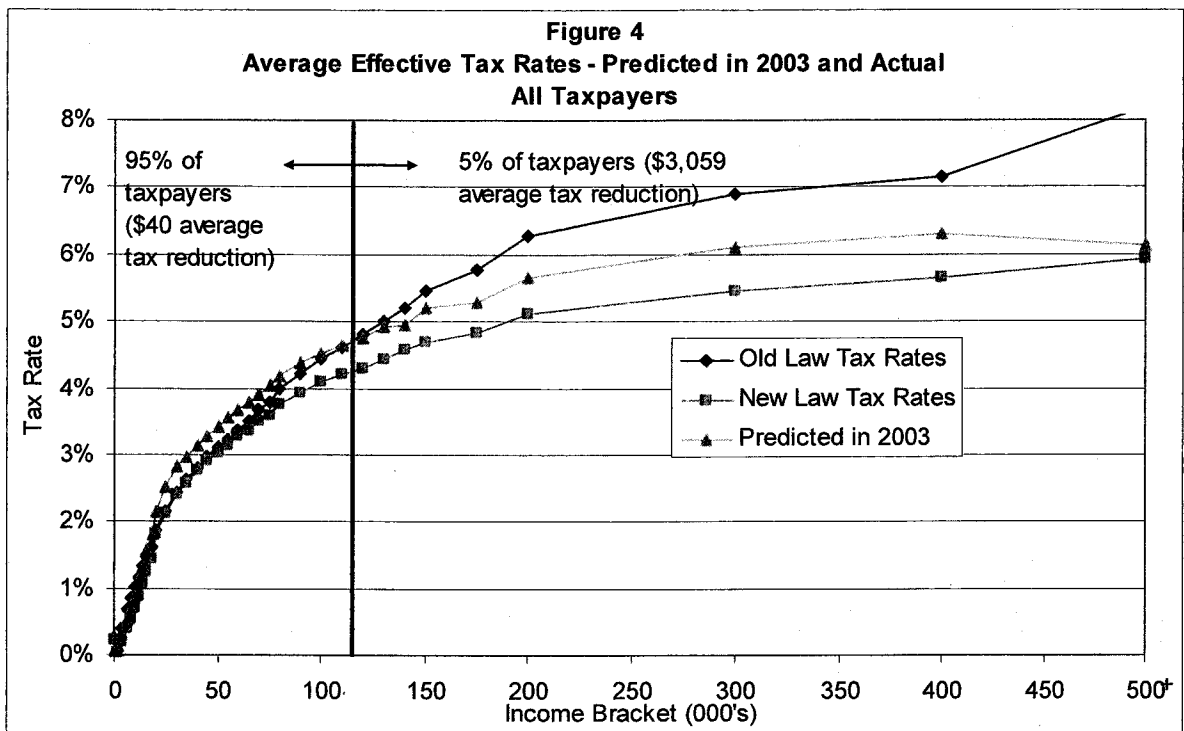


Figures 4 and 5, on the next page, show the difference between the forecasted and actual impact of SB407 across income groups as a plot of average effective tax rates for each income bracket. The average effective tax rate is the total tax paid by households in an income bracket divided by the total of their household incomes.

Figure 4 and Figure 5 both show average effective tax rates under:

- the pre-SB407 (old) law using tax year 2005 return information,
- as predicted for SB407 in 2003, and
- actual SB407 from 2005 tax returns.

Figure 4, which shows all tax brackets, shows what happened to high-income taxpayers well. But 95% of taxpayers are in the area to the left of \$110,000 of household income. To better show what happened to these taxpayers, Figure 5 shows only the brackets with incomes less than \$110,000.



Winners and Losers

Not all taxpayers received a tax cut because of SB407. The rate table changes reduced the marginal rate at most taxable income levels but increased it in some ranges. The capital gains tax credit reduced taxes for those taxpayers who have capital gains income, but only 17% of households reported positive capital gains for 2005. The cap on the itemized deduction for federal income taxes increases Montana income tax for those taxpayers who itemize deductions and paid federal income taxes that were more than the cap.

In most income brackets, some taxpayers pay less with SB407, some pay more, and some have essentially "no change" in their tax liability. (To be consistent with the original analysis done during the 2003 session, taxpayers with a change in liability of less than \$50, either up or down, are considered to have "no change" in their tax.)

Table 4, on the next page, shows the number of taxpayers in each income bracket with a tax reduction of more than \$50, with a tax increase of more than \$50, and with a change of less than \$50 either way.

Table 4
Winners and Losers from SB 407

Income Brackets		Tax Reduction > \$50		Tax Increase > \$50		Change < \$50	
Income Range	Number of Households in Bracket	Number of Households	% of Households in Bracket	Number of Households	% of Households in Bracket	Number of Households	% of Households in Bracket
\$ 0 - \$ 1,999	13,549	27	0.2%	1	0.0%	13,521	99.8%
\$ 2,000 - \$ 3,999	17,822	14	0.1%	1	0.0%	17,807	99.9%
\$ 4,000 - \$ 5,999	18,096	19	0.1%	2	0.0%	18,075	99.9%
\$ 6,000 - \$ 7,999	17,239	267	1.5%	1	0.0%	16,971	98.4%
\$ 8,000 - \$ 9,999	16,723	1,997	11.9%	2	0.0%	14,724	88.0%
\$ 10,000 - \$ 11,999	16,095	6,981	43.4%	0	0.0%	9,114	56.6%
\$ 12,000 - \$ 13,999	15,301	6,758	44.2%	3	0.0%	8,540	55.8%
\$ 14,000 - \$ 15,999	14,825	3,370	22.7%	5	0.0%	11,450	77.2%
\$ 16,000 - \$ 17,999	14,645	2,713	18.5%	10	0.1%	11,922	81.4%
\$ 18,000 - \$ 19,999	13,799	2,289	16.6%	7	0.1%	11,503	83.4%
\$ 20,000 - \$ 24,999	29,860	4,504	15.1%	61	0.2%	25,295	84.7%
\$ 25,000 - \$ 29,999	24,717	3,979	16.1%	146	0.6%	20,592	83.3%
\$ 30,000 - \$ 34,999	21,401	3,705	17.3%	383	1.8%	17,313	80.9%
\$ 35,000 - \$ 39,999	18,447	4,190	22.7%	783	4.2%	13,474	73.0%
\$ 40,000 - \$ 44,999	16,572	4,364	26.3%	1,410	8.5%	10,798	65.2%
\$ 45,000 - \$ 49,999	14,713	4,650	31.6%	1,770	12.0%	8,293	56.4%
\$ 50,000 - \$ 54,999	13,603	4,975	36.6%	2,041	15.0%	6,587	48.4%
\$ 55,000 - \$ 59,999	12,312	5,007	40.7%	2,361	19.2%	4,944	40.2%
\$ 60,000 - \$ 64,999	11,223	4,809	42.8%	2,395	21.3%	4,019	35.8%
\$ 65,000 - \$ 69,999	9,832	4,557	46.3%	1,973	20.1%	3,302	33.6%
\$ 70,000 - \$ 74,999	8,699	4,408	50.7%	1,694	19.5%	2,597	29.9%
\$ 75,000 - \$ 79,999	7,549	4,280	56.7%	1,293	17.1%	1,976	26.2%
\$ 80,000 - \$ 89,999	11,930	7,500	62.9%	2,166	18.2%	2,264	19.0%
\$ 90,000 - \$ 99,999	8,388	5,775	68.8%	1,541	18.4%	1,072	12.8%
\$100,000 - \$109,999	5,670	4,150	73.2%	990	17.5%	530	9.3%
\$110,000 - \$119,999	4,092	3,015	73.7%	752	18.4%	325	7.9%
\$120,000 - \$129,999	2,965	2,297	77.5%	471	15.9%	197	6.6%
\$130,000 - \$139,999	2,210	1,752	79.3%	320	14.5%	138	6.2%
\$140,000 - \$149,999	1,680	1,390	82.7%	229	13.6%	61	3.6%
\$150,000 - \$174,999	2,957	2,491	84.2%	389	13.2%	77	2.6%
\$175,000 - \$199,999	1,856	1,614	87.0%	206	11.1%	36	1.9%
\$200,000 - \$299,999	3,585	3,171	88.5%	363	10.1%	51	1.4%
\$300,000 - \$399,999	1,353	1,235	91.3%	105	7.8%	13	1.0%
\$400,000 - \$499,999	709	644	90.8%	61	8.6%	4	0.6%
\$500,000+	1,567	1,468	93.7%	91	5.8%	8	0.5%
TOTALS	395,984	114,365	28.9%	24,026	6.1%	257,593	65.1%

Twenty-nine percent of households had a tax reduction of at least \$50. In general, the percentage of households with tax liability at least \$50 lower with SB407 is higher at higher incomes. It increases from essentially 0% in the lowest income brackets to 93.7% in the highest. The only exception to the steady increase in the percent of households with a reduction as income rises is between \$10,000 and \$20,000. Households in this income range benefited from the drop in the lowest tax rate from 2% to 1%.

Above \$75,000 of income, a majority of taxpayers had a tax decrease. Below \$75,000 of household income, a majority of taxpayers had no change or a tax increase.

Six percent of households paid at least \$50 more with SB407. The percentage paying at least \$50 more is highest at 21.0% for the \$60,000 to \$65,000 income bracket. From this point, the percentage paying at least \$50 more generally decreases as income either rises or falls, but averages 10% or more for households in all income brackets between \$45,000 and \$300,000.

Sixty-five percent of households saw a change in tax liability of less than \$50. This percentage decreases from essentially 100% of households with the lowest incomes to less than 1% of households with the highest incomes.

These figures are very close to the original 2003 estimates which forecast that 27% of households would have a tax reduction of \$50 or more; 6.4% of households would have a tax increase of \$50 or more; and 67% of households would have "no change".

Figure 6 shows the percent of households in each income bracket with a tax reduction of at least \$50.

